



APPRAISAL REPORT

CAO Appraisal for Audit of IFC

CAO Compliance

C-I-R9-Y11-F145

November 3, 2011

**Procesadora Nacional de Alimentos C.A. (PRONACA) Pig and Poultry Farms
Santo Domingo, Ecuador**

Summary

PRONACA (Procesadora Nacional de Alimentos C.A.) is an integrated pork and poultry processing company. PRONACA has been an IFC client since 2003. IFC has invested a total of US\$50 million (in two investments, one in 2004 and one in 2008) to allow PRONACA to expand, recapitalize, and upgrade its operations. IFC also provided Advisory Services to PRONACA relating to water treatment and increasing energy efficiency.

IFC approved the first investment under the Safeguard Policies, and the second investment under the Performance Standards. IFC's appraisal of the 2004 investment identified an expected gap between PRONACA's performance at that time and the relevant IFC/World Bank Group guidelines. An Environmental and Social Action Plan (ESAP) was agreed as part of the second investment in 2008.

On December 7 and 30, 2010, the CAO received a complaint from two individuals raising concerns about water and soil pollution and foul odors emanating from PRONACA's facilities in Santo Domingo, and the impact of this pollution on human health and nearby ecosystems, as well as compliance with Ecuadorian law.

Annual Monitoring Reports (AMRs) prepared and submitted, such as the 2008 AMR submitted on 15 November 2008, to IFC by PRONACA identify a variety of noncompliances with IFC/World Bank Group guidelines. Since then, the quality of the AMRs themselves, as well as the data that they report, has improved. The 2011 AMR reports considerable improvement in discharges to water; most waste water noncompliances reported previously are no longer present.

The CAO finds that there is evidence of a productive and collaborative relationship between IFC and PRONACA. Since disbursement of the investments IFC has worked with PRONACA to recognize deficiencies and design and implement improvements in environmental performance. Progress has also resulted from the use of the expertise of IFC's Advisory Services and the provision of external consultancy services that IFC has assisted in identifying and funding.

The CAO finds that the reporting of data to IFC (for example, in the AMRs) is insufficient to give IFC full assurance that the operations are in compliance with applicable IFC guidelines. IFC recognizes this deficiency and it is the subject of proposed future action by IFC.

The CAO concludes that this case does not merit an audit of IFC's due diligence and monitoring of its involvement linked to the operations of PRONACA. The CAO will close this case with no further action.

Office of the Compliance Advisor/Ombudsman (CAO)
for the
International Finance Corporation (IFC)
Multilateral Investment Guarantee Agency (MIGA)
Members of the World Bank Group



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About the CAO

The CAO's mission is to serve as a fair, trusted, and effective independent recourse mechanism and to improve the environmental and social accountability of IFC and MIGA.

The CAO (Office of the Compliance Advisor/Ombudsman) is an independent post that reports directly to the President of the World Bank Group. The CAO reviews complaints from communities affected by development projects undertaken by the two private sector lending arms of the World Bank Group: the International Finance Corporation (IFC) and the Multilateral Investment Guarantee Agency (MIGA).

For more information about the CAO, please visit www.cao-ombudsman.org

1. Overview of the CAO Compliance Appraisal Process

When the CAO receives a complaint about an IFC or MIGA project, the complaint is first referred to the ombudsman arm of the CAO, *CAO Ombudsman*, which works to respond quickly and effectively to complaints through facilitated settlements, if appropriate. If CAO Ombudsman concludes that the parties are not willing or able to reach a facilitated solution, the case will be transferred to the compliance arm of the CAO, *CAO Compliance*, to appraise the concerns raised in the complaint for a *compliance audit* of IFC or MIGA. Alternatively, a compliance audit can be initiated by request from the President of the World Bank Group, the senior management of IFC or MIGA, or at the discretion of the CAO Vice President.

A *CAO compliance appraisal* is a preliminary investigation to determine whether the CAO should proceed to a compliance audit of IFC/MIGA. Through CAO compliance appraisals, the CAO ensures that compliance audits of IFC/MIGA are initiated only for those cases that may raise substantial concerns regarding social or environmental outcomes.

A compliance audit is concerned with assessing the application of relevant policy provisions and related guidelines and procedures to determine whether IFC/MIGA is/are in compliance. The primary focus of compliance auditing is on IFC/MIGA, but the role of the sponsor may also be considered.

A compliance audit appraisal, and any audit that ensues, must remain within the scope of the original complaint or request. It cannot go beyond the confines of the complaint or request to address other issues. In such cases, the complainant or requestor should consider a new complaint or request.

The CAO compliance appraisal will consider how IFC/MIGA assured itself/themselves of compliance with national law, reflecting international legal commitments, along with other audit criteria. The CAO has no authority with respect to judicial processes. The CAO is not an appeals court or a legal enforcement mechanism, nor is the CAO a substitute for international court systems or court systems in host countries.

The appraisal criteria are set forth in CAO's Operational Guidelines. The criteria are framed as a series of questions to test the value of undertaking a compliance audit of IFC or MIGA. The criteria are as follows:

- Is there evidence (or perceived risk) of adverse social and environmental outcomes that indicates that policy provisions (or other audit criteria) may not have been adhered to or properly applied?
- Is there evidence of risk of significant adverse social and environmental outcomes that indicates that policy provisions, whether or not complied with, have failed to provide an adequate level of protection?
- Is there evidence (or perceived risk) of significant adverse social and environmental outcomes where policy provisions, standards, or other audit criteria were not thought to be applicable but perhaps should have been applied?



- Is there evidence that the application of some aspect of a policy, standard, guideline, or procedure resulted in adverse social and environmental outcomes?
- Can the cause of adverse social and environmental outcomes not be readily identified and corrected through the intervention of the project team without a detailed investigation of the underlying causes or circumstances?
- Could a compliance audit yield information or findings that might better inform the application of policies (or other audit criteria) to future projects?

During appraisal, CAO Compliance holds discussions with the IFC/MIGA project team and other relevant parties to understand the validity of the concerns and to explore whether an audit would be warranted.

After a compliance appraisal has been completed, the CAO can choose only one of two options: to close the case, or to initiate a compliance audit of IFC/MIGA.

The CAO will report and disclose the findings and decision of the CAO compliance appraisal in an appraisal report in order to inform the President of the World Bank Group, the Boards of the World Bank Group, senior management of IFC/MIGA, and the public in writing about its decision.

If the CAO decides to initiate a compliance audit as a result of the compliance appraisal, the CAO will draw up a Terms of Reference for the audit in accordance with CAO's Operational Guidelines.

2. Background and Concerns that Led to the Appraisal

On December 7 and 30, 2010, the CAO received correspondence from two individuals who alleged that the activities of Procesadora Nacional de Alimentos C.A. (PRONACA), an IFC client, are having a negative impact on the environment and well-being of the inhabitants of Santo Domingo, Ecuador.

The complainants' concerns were presented together with information gathered from diverse sources such as press articles, letters to authorities requesting that they attend to their concerns, documentation on the judicial procedures filed against PRONACA, and other information.

The CAO deemed the complaints eligible for assessment on January 7, 2011, and the CAO Ombudsman began the assessment of opportunities for resolving the issues in the complaint. The CAO team made two trips in February and March, 2011 to Santo Domingo and met with various local stakeholders, and visited several of PRONACA's that had been suggested by the complainants and PRONACA, and that also represented different stages of the company's production chain. Specifically, the CAO team visited the San Xavier farm, the Socorro farm, the Chanchos Plata 2 farm, the FRIMACA pork processing plant, and the water treatment plant in Valle Hermoso.

Both complainants did not wish to participate in a fact-finding process supported by the CAO's dispute resolution function. In April 2011, at the request of the complainants, the complaint was transferred to CAO Compliance for appraisal.

Investment Background

PRONACA is an integrated pork and poultry processing company. It has been an IFC client since 2003. PRONACA proposed two investment projects to expand, recapitalize, and upgrade its operations, and IFC supported these activities through two loans (in 2004 and 2008) totaling US\$ 50 million. The IFC provided Advisory Services to PRONACA relating to water treatment and increasing energy efficiency. PRONACA expected to use the 2008 loan to support key investments to maintain its operations and to finance permanent working capital.

IFC classified the investments as environmental category B projects according to IFC's Procedure for Environmental and Social Review of Projects, in the belief that "a limited number of specific environmental and social impacts may result that can be avoided or mitigated by adhering to generally recognized Performance Standards, guidelines or design criteria (limited environmental impacts)."

3. Scope of the Appraisal for a Compliance Audit of IFC

As discussed in Section 1, appraisals are limited to examining the issues related to the complaint and determining how they relate to the performance of IFC/MIGA and its obligations under the relevant standards, guidelines, and procedures.

The complaint alleges, among other things, the following social and environmental concerns regarding PRONACA's operations:

- Foul odor emanating from the pig farms
- Pollution of water sources, soil and air
- Operation of pig farms without an environmental license
- An excessive number of pigs in the Province of Santo Domingo de los Tsachilas
- Health issues in neighboring communities, and
- Impacts on a buffer forest.

IFC Standards, Guidelines, and Procedures

The framework of IFC's due diligence is provided by IFC's Performance Standards, in combination with relevant EHS (Environmental, Health and Safety) Guidelines.

The IFC's Safeguard Policies were formally put in place in December 1998 and were superseded by the Performance Standards on 30 April 2006.

The first investment was approved under the Safeguard Policies. The second was approved under the Performance Standards. Since both investments related to the same operations, the requirements of PRONACA to comply with the Safeguard Policies was superseded by the requirements of the second loan to comply with the Performance Standards.

IFC stated in its Environmental and Social Assessment Summary (May, 21, 2008), that the following environmental and social standards were found applicable to PRONACA's operations:

- PS1: Social and Environmental Assessment and Management Systems
- PS2: Labor and Working Conditions
- PS3: Pollution Prevention and Abatement
- PS4: Community Health, Safety and Security
- PS5: Land Acquisition and Involuntary Resettlement, and
- PS6: Biodiversity Conservation and Sustainable Natural Resource Management.

The Environmental and Social Review Procedures require IFC to review the project against the Performance Standards and good international practice standards as set out in the EHS Guidelines. In addition, an assessment typically includes a review of the track record, technical capacity, corporate and project-specific management systems of the client/operator, and business and technical risk and associated risk mitigation measures.

IFC's Due Diligence and Follow-up

The appraisal of the 2004 investment identified an expected gap between performance and the relevant IFC/World Bank Group guidelines. As a result, an Environmental and Social Action Plan (ESAP) was agreed as part of the second investment in 2008. This ESAP required three actions to be performed within the first year after signing of the investment agreement:

- Upgrade the corporate integrated management system to include social and environmental affairs, and occupational health and safety management (ESMS).
- Formalize and implement an effective grievance redress mechanism to address workers grievances.



- Assess the new wastewater treatment facilities (bio-digesters and activated sludge plants) and, following suitable monitoring of effluent waste water quality, if necessary, identify any further upgrades or modifications required to meet IFC guidelines.

The ESAP at that time did not identify actions related to local community liaison, grievance handling, or Annual Monitoring Reports (AMRs).

PRONACA submitted the Annual Monitoring Reports (AMRs) for both investments to IFC; the AMRs allowed IFC to monitor compliance against relevant criteria.

The 2010 AMR (dated January 31, 2011) reports lower levels of pollution being released to air and water. IFC assured itself through this and previous AMRs that the operations of PRONACA were showing continued improvement in emissions to air and water and were in compliance with IFC guidelines for most parameters and most locations. The AMR showed considerable improvement between 2010 and 2011 data; most waste water noncompliances reported previously were no longer present in the 2011 report.

4. Findings of the CAO Appraisal

a. Odors

Good practice in relation to odor management in farms of this type would include bio-digesters and deep bedding, as well as control of all potentially odorous materials. In addition, good practice would include the establishment of a grievance/complaint mechanism that allows locally affected communities to interact with the farm operators to (a) allow operators to inform potentially affected communities when odorous activities may increase, and (b) allow communities to inform/complain to the operators when odors are a nuisance. PRONACA has indicated in discussions with IFC that they are open to such mechanisms. Good practice would also consider the location of new or expanded facilities in relation to the distance to neighbors and the propagation of odors.

IFC has worked with PRONACA since the initial investment to identify and introduce measures to reduce odors, including providing technical assistance. PRONACA has also implemented deep bedding and bio-digesters – both of which will reduce odors dramatically if well managed.

b. Water Pollution

All parties agree that river pollution exists, but PRONACA and the complainants disagree about the causes. Some residents believe that solid and liquid wastes from the PRONACA pig farms are being released into the rivers without treatment. PRONACA contends that liquid wastes are treated and that no solid wastes are discharged into water sources. The implementation of deep-bedding will assist in the reduction of waste water. Waste water treatment facilities have been installed to reduce the contaminants discharged into the river. Annual reporting by PRONACA to IFC has shown significant improvement in most determinants, although some non-compliances remain in relation to Biochemical Oxygen Demand (BOD), Chemical Oxygen Demand (COD), oil & grease, and *coliform* bacteria. These are identified in the latest (2011) annual report to IFC. IFC identified actions to further assure itself of the performance in regard to these specific parameters. As part of PRONACA's waste water management, IFC has also encouraged PRONACA to sample river water upstream and downstream discharge points in order to create a dataset that can be used to investigate claims that the river is polluted upstream by other operators and/or urban centers.

c. *Environmental Licenses and Other Operating Permits*

During the CAO Ombudsman's investigations, PRONACA and the complainants agreed that not all operations relating to pig breeding and processing have environmental licenses approved by the Ecuadorian Ministry of the Environment. IFC has assured itself, and PRONACA states, that it has fulfilled the requirements and is waiting for the environmental authorities to grant the remaining environmental licenses. Granting of licenses is outside the control of PRONACA.

d. *Flies and Mosquitoes*

Some inhabitants of the town of El Paraíso blame the pig farming for increasing the number of flies and mosquitoes in the area. PRONACA asserts it is not responsible, and is cooperating with the fumigation and education campaigns being carried out by the local authorities.

e. *Scale of the Operation and Access to Information on its Production Processes*

The complainants believe the pig farms are overpopulated with pigs and that the area has too many pig farms. PRONACA asserts that its facilities are not over populated and that the facilities are open to independent inspection. IFC and CAO staff have visited PRONACA's sites and have been given access to all requested information.

f. *Dynamics of the Relations between the Communities and the Company*

Under its Corporate Responsibility Department, PRONACA has a unit dedicated to relations with interest groups. However, international good practice stipulates that both the communities and the company would benefit if there were a dedicated mechanism for handling complaints.

g. *Siting of facilities near population centers*

The complainants expressed concerns about how close some of the pig farms are to populated centers. Expansion of human populations in the vicinity of existing facilities is not within the control of PRONACA. However, expansion of PRONACA operations toward human populations is. IFC guidelines suggest that distances between farms and populated areas can be taken into account in siting new farms or the expansion of existing ones¹.

IFC requested that PRONACA undertakes an Environmental Impact Assessments (EIAs). The documents seen by CAO show these EIAs to be tables of sampling data upstream and downstream of specific water outfalls to the river, and so are not what is usually referred to as an EIA. The CAO notes that a full Environmental Impact Assessment (EIA) is not mandatory for a Category B project.

h. *Compliance with administrative and Legal Procedures*

During consultations, the CAO Ombudsman function determined that the Constitutional Court in Ecuador mandated the creation of a multi-sector commission convened by the Defensoría del Pueblo seeking to defend common, collective rights. The commission was charged with strictly monitoring PRONACA's production business with regard to bio-digester functioning, water consumption, and management of organic and inorganic wastes dumped into bodies of water. This commission was set up in July 2009, visited PRONACA's operations, and is in the process of generating a preliminary report.

¹ IFC/ World Bank Group, (2007) Environmental, Health, and Safety Guidelines for Mammalian Livestock Production.



CAO Appraisal Conclusions

The CAO finds that there is evidence of productive and collaborative relationship between IFC and PRONACA. IFC has worked with PRONACA since disbursement of the investments to recognize deficiencies, and to design and implement improvements in environmental performance. Progress has also resulted from the use of the expertise of IFC's Advisory Services and the provision of external consultancy services that IFC has assisted in identifying and funding.

The CAO finds that the Environmental and Social Action Plan drawn up as part of the documentation for the second investment could have better leveraged IFC's potential influence to improve as many issues as possible within its purview. However, work by IFC since the commencement of the second investment has addressed these issues.

IFC investment staff have visited PRONACA and assured themselves that PRONACA is implementing the measures required to address the gaps in performance identified at the time of the initial investment.

The CAO finds that the reporting of data to IFC (for example, in the AMRs) is insufficient to give IFC full assurance that the operations are in compliance with applicable IFC guidelines. IFC recognizes this deficiency and it is the subject of proposed future action by IFC.

With regard to the appraisal question whether a compliance audit could yield information or findings that might better inform the application of policies (or other audit criteria) to future projects, the CAO finds that an audit of IFC's due diligence of the investments related to PRONACA against the applicable policy provisions would yield limited information and be of limited value beyond what this appraisal has identified.

5. The CAO Decision

The CAO concludes that IFC has assured itself of the performance of the client. IFC has identified gaps and corresponding actions to close such gaps, such as improved reporting of environmental data in the AMRs. In hindsight, it would have been desirable for IFC to have identified gaps earlier and for PRONACA to have responded more quickly to these gaps such that the pace of implementing identified actions was quicker. In this case, however, this does not constitute a violation of a policy or failure on IFC's part to assure itself of the performance of the client.

The CAO concludes that this case does not merit an audit of IFC's due diligence and monitoring of its involvement linked to the operations of PRONACA. The CAO will close this case with no further action.